BEFORE THE

SURFACE TRANSPORTATION BOARD

218415

Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

Joint Written Rebuttal Comments

submitted by

American Chemistry Council, American Forest and Paper Association, American Soybean Association, Agricultural Retailers Association, Colorado Wheat Administrative Committee, Corn Refiners Association, The Fertilizer Institute, Glass Producers Transportation Council, Idaho Barley Commission, Idaho Wheat Commission, Institute of Scrap Recycling Industries, Iowa Soybean Association, Montana Wheat and Barley Committee, National Association of Wheat Growers, National Barley Growers Association, National Corn Growers Association, National Council of Farmers Cooperatives, National Farmers Union, National Grain and Feed Association, National Sorghum Producers, The National Industrial Transportation League, National Oilseed Processors Association, National Petrochemical & Refiners Association, Nebraska Wheat Board, North American Millers Association, North Dakota Grain Dealers Association, North Dakota Public Service Commission, North Dakota Wheat Commission, Oklahoma Wheat Commission, Paper and Forest Industry Transportation Committee, PPL EnergyPlus, LLC, South Dakota Wheat Commission, Texas Wheat Producers Board, USA Rice Federation, Washington Wheat Commission, Alliance for Rail Competition, Consumers United for Rail Equity

and

The Honorable Brian Schweitzer, Governor, State of Montana

I. <u>INTRODUCTION.</u>

These Interested Parties submitted Joint Written Comments in this proceeding on October 24, 2006, and Joint Written Reply Comments on November 30, 2006, in response to the Board's request for comments in STB Ex Parte No. 646 (Sub-No. 1), *Simplified Standards for Rail Rate Cases* (served July 28, 2006) ("*Decision*"). Various other parties, including the Association of

American Railroads ("AAR") and each of the Class I railroads also filed opening and reply comments. Through these Joint Written Rebuttal Comments and the attached Rebuttal Verified Statement of Gerald W. Fauth, III ("Fauth R.V.S."), the Interested Parties respond to the reply comments submitted by the various railroad industry participants.

As an overall matter, the Interested Parties remain extremely troubled by the Board's proposals, which will make an already untenable situation much worse. Furthermore, most of the modifications proposed by the railroad industry would only exacerbate this situation. Although the current situation is very far from ideal, at least shippers know they have the opportunity to make a small rate challenge on the facts of their case and will not be barred arbitrarily from bringing a complaint. In contrast, the proposed rules—and particularly the unrealistically low eligibility standards and the draconian aggregation rule—would slam the door shut against most, if not all, small rate challenges from the moment of inception. Instead, those cases would be thrust into either the large case category that is required to use the full stand-alone cost ("Full-SAC") approach, which is prohibitively expensive and unworkable for virtually all shippers, or the newly-created "medium-sized" category that is required to use the newly-proposed simplified stand-alone cost ("SSAC") approach. Most traffic movements that might qualify for the Three-Benchmark approach would be denied any regulatory protection by operation of the proposed aggregation rules and the fact that SSAC relief is simply "too costly."

The Interested Parties believe that SSAC for medium cases is unclear, unfair, unworkable and unlawful. Moreover the Board's cost and time assumptions for prosecuting an SSAC case are drastically understated. Because the Interested Parties do not believe that SSAC is workable or fixable, they continue to urge the Board to abandon that approach.

The Interested Parties urge the Board to focus its efforts on clarifying and revising the existing Three-Benchmark approach, which currently is *the standard* for all small rate cases. Several of the Board's proposals are promising, and the Interested Parties have offered certain enhancements to those proposals. With those enhancements and upward revisions to the eligibility threshold, the Interested Parties ask the Board to allow the Three-Benchmark approach to function as envisioned when it was adopted as *the* small case standard 10 years ago.

The railroad industry unfairly accuses the Interested Parties of not making constructive suggestions. Since the Interested Parties have in fact have made several constructive suggestions on both eligibility and the Three-Benchmark approach, the railroad criticism can only be directed at the Interested Parties' opposition to SSAC. But ten years ago the Board itself concluded that another version of SSAC was unworkable, when it adopted the Three-Benchmark approach in *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004, 1012-15 (1996) ("*Simplified Guidelines*"). The Interested Parties merely contend that this conclusion continues to be true, and that no amount of "constructive" suggestions will change this fact. Therefore, it is unfair to fault the Interested Parties for refusing to play on a slanted field.

II. <u>CONGRESS HAS NOT MANDATED CMP FOR SMALL RATE CASES.</u>

Although the railroads are effusive in their praise of Constrained Market Pricing ("CMP"), there is no statutory requirement for preserving CMP as the model for small rate cases. Congress called for a different standard of rate reasonableness in such cases, and the ICC's development of the Three Benchmark approach as a different standard was underway when the ICCTA and Section 10701(d)(3) were enacted. Indeed, Congress established a one-year deadline for completion of Ex Parte No. 347 (Sub-No. 2), *Rate Guidelines – Non-Coal Proceedings*, because of impatience with the ICC's failure to act in its "long-pending non-coal rate guidelines proceeding, which is aimed at providing simplified and more cost-effective evidentiary standards for rate reasonableness cases."[1]

Absent from or downplayed in the railroads' comments is the basic legal principle that agencies are bound by their governing statutes, and that in the ICCTA, Congress amended the Interstate Commerce Act to mandate an alternative to stand-alone cost ("Full-SAC"). While the railroads are insistent that this alternative be based on CMP, CMP is merely another way of saying Full-SAC, since the only other constraint – revenue adequacy – has never been implemented in any rail rate case.[2]

The alternative to Full-SAC is required to be a "simplified and expedited method for determining the reasonableness of rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3). The Congressional intent underlying this amendment is not ambiguous or mysterious. Congress was well aware that the ICC had failed for 16 years to give effect, for the vast majority of captive shippers, to the Staggers Act mandate that rail rates on captive traffic "must be reasonable." 49 U.S.C. § 10701(d)(1).

When the Board adopted the Three Benchmark approach in *Simplified Guidelines*, there was no indication that SAC or CMP could or should be the basis for the methodology adopted for small rate cases. On the contrary, the Board concluded (1 S.T.B. at 1021):

> We must reject AAR's underlying assumption that CMP is susceptible to adequate simplification without losing its effectiveness, and that other (non-CMP) simplified procedures cannot be considered.

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1 *See* House Conference Report No. 104-422 at 170, *reprinted in* 1995 U.S.C.C.A.N. 793, 855.

2 Interested Parties are aware that CMP also includes management inefficiency and phasing. However, phasing merely delays rate increases and cannot produce reductions in maximum reasonable rates, and management inefficiency is irrelevant except where railroad management inefficiency is so massive as to cause revenue inadequacy by itself. In other words, the management efficiency constraint is merely a subset of the revenue adequacy constraint. *See Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520, 534 (1985) ("*Guidelines*").

The Board noted that "other procedures can, and indeed must, be made available for those cases in which CMP simply cannot be used—because the traffic is so infrequent or widely dispersed that it is not susceptible to a SAC presentation or because the case is so small in value that the substantial expense of a CMP presentation...cannot be justified." *Id.*

Although the Board contends that its experience with Full-SAC has enabled it to identify new approaches to simplification of the Full-SAC methodology, the Interested Parties demonstrate that the Board's modifications do not make SSAC simple enough or inexpensive enough to satisfy the statute. Moreover, the Board's supposed simplifications eliminate most of the benefits of Full-SAC, and hence CMP, for captive shippers, thereby producing a rate that is higher than CMP would permit.[3] Attempts to justify this result as a trade-off necessary for simplicity plainly makes a mockery of the goal of parity of outcomes between Full-SAC cases and rate relief in small cases as contemplated by Congress in Section 10701(d)(3). Despite the Board's claims that its SSAC rules are a justified trade-off between accuracy and simplicity, there is no proof of that claim by the Board or by the railroads, which generally support the proposed SSAC rules. This lack of proof is all the more glaring given the fact that the Board previously recognized the need to test new rate standards itself and did so when it last conducted a proceeding under Section 10701(d)(3).

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3 At least one major railroad tacitly acknowledges that SSAC serves to "bless" challenged rail rates.

> If the SARR traffic group consists of the traffic that in the real world shares the facilities at issue, it is reasonable to assume that the SARR would also use the same basic facilities as the incumbent. There is no reason to believe that an efficient SARR would be able to provide service to the incumbent's traffic using substantially different facilities or with substantially lower operating costs.

BNSF Reply at 18. Thus, the railroads view SSAC as supportive of the status quo, which has denied rate protection in small rate cases for over a decade.

Nothing in Section 10701(d)(3) suggests that SAC-based ratemaking in small rate cases is acceptable so long as the Board adopts what it regards as streamlining changes in Full-SAC. What Congress called for was an alternative to SAC. The Board and the railroads have provided no basis for concluding that SSAC satisfies the statute.

III. REALISTIC ELIGIBILITY THRESHOLDS ARE AN ESSENTIAL PREDICATE TO MEANINGFUL REGULATORY PROTECTIONS IN SMALL RATE CASES.

As noted in these and in earlier comments, the ICCTA mandate, which took effect on January 1, 1996, that the "Board shall, within one year after the effective date of this paragraph, complete the pending Interstate Commerce Commission non-coal rate guidelines proceeding to establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case,"[4] was intended to provide practicable access to a rate reasonableness remedy in all instances where a rail carrier has market dominance over the transportation to which a challenged rate applies. As the Board has stated: "Under the statute, no rate – other than a contract rate ... or one that has been exempted ... can be immune from regulatory challenge by a shipper that establishes market dominance." *Simplified Guidelines*, 1 S.T.B. at 1053. If a rate complaint based on a Full-SAC presentation is "too costly, given the value of the case," a "simplified and expedited method" *must* be made available to the complainant.

The shipper parties have been highly critical of the eligibility standards in the proposed rules because those standards frustrate the statutory goal of a truly "simplified" process in *each instance* where a "full stand-alone presentation is too costly, given the value of the case." The proposed rules would contradict the statute essentially because they require shippers who want

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[4] 49 U.S.C. § 10701(d)(3).

rate relief to utilize procedures that often are more costly than the value of their cases and which would leave many shippers without access to any effective remedy whatsoever.

The Board apparently reasons that, if an SSAC case can be maintained for $200,000 (a figure that is so unrealistically low as to disqualify virtually all shippers, as discussed below), then it is permissible to narrowly confine access to the truly simplified and expedited Three-Benchmark process even when the so-called SSAC procedure will cost what that shipper's case is worth, or even more. That reasoning is nonsensical. Congress intended to make "a simplified and expedited" process available in each instance where Full-SAC is too costly. The Board cannot frustrate that purpose by creating a new three-tier system and by claiming that those shipments deprived of access to the simplified lowest tier, Three-Benchmark, by aggregation or other rules can always use the middle tier, SSAC, even when SSAC is too costly. If an SSAC case is "too costly" for a Three-Benchmark shipment, it follows *a priori* that a Full-SAC case likewise must be too costly. The Board cannot devise a new Section 10701(d)(3) process that effectively makes all three tiers of relief unavailable as a practical or legal matter for a wide swath of jurisdictional shipments.

A. **The Railroad Replies Fail to Support the Board's Monetary Ceilings for Full-SAC and SSAC Relief.**

The *Decision* concludes that a Full-SAC case can be maintained by a shipper for no more than $3.5 million and an SSAC case for no more than $200,000, leading the Board to conclude that any case with a maximum "value" of less than $3.5 million is eligible for SSAC procedures and that cases with a maximum "value" of less than $200,000 can proceed under either the Three-Benchmark or SSAC standard, subject to various additional rules placing limitations on monetary relief. The Interested Parties have demonstrated that these thresholds must be increased dramatically.

1. **<u>Only the Interested Parties have submitted detailed litigation cost estimates.</u>**

The Interested Parties assailed the Board's eligibility boundaries as drastically understated for a variety of reasons, including a lack of factual foundation. The railroads defend the Board's boundaries, although they offer no evidence to support that defense. *See, e.g.*, UP Reply at 51; CSX-NS Reply at 7 (arguing that, even if the Board's standards are off the mark, they are simply presumptions and can be challenged in each case, an argument that is flatly inconsistent with rate case simplification).

Unlike the carriers, the shippers have offered evidence to support their view that it will cost more to maintain either a Full-SAC or SSAC case than is recognized by the proposed rules. The railroads offer no evidence to contradict these estimates or to support the Board's conjecture. Instead, the railroads try to make do by levying criticism at their opponents' estimates. Their criticisms are inaccurate and an inadequate substitute for probative evidence.

The Interested Parties presented the evidence of two experienced cost consultants to explain the understatements in the Board's estimates. Thomas D. Crowley, who has represented complainants in almost every Full-SAC complaint before the Board, concluded that "minimum consulting fees to present a Full-SAC analysis would equal $2.25 million, and could run upwards of $4.0 million depending upon the complexity of the case and the number of rounds of evidence required."[5] After adding attorney's fees, estimated to be 75% of consulting fees, he concluded that total costs would range between $4.0 and $7.0 million.[6]

Mr. Crowley also estimated that consulting fees for an SSAC presentation will range from $1 to $2 million, and, with legal fees at 75% of consulting fees, would result in <u>total</u> costs

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5 Opening Verified Statement of Thomas D. Crowley, p. 23.
6 *Id.*

of between $1.75 and $3.5 million to maintain an SSAC case.[7] Gerald W. Fauth, III, likewise an experienced cost consultant who has participated in rate complaints before the Board, concluded that the economic consulting fees in an SSAC case are likely to range between $500,000 and $1.25 million, <u>excluding</u> legal fees and out-of-pocket costs.[8] These realistic estimates, multiplied by a risk factor as discussed below, should become the basis for the eligibility thresholds.

Although the *Decision* contains no estimates of the costs for bringing a Three-Benchmark case, the ceiling of $200,000 on Three-Benchmark relief implies that the costs for such a case must be considerably lower than $200,000. The Interested Parties' Witnesses Crowley and Fauth have presented evidence indicating that costs for maintaining a Three-Benchmark case under the proposed rules are likely to be well in excess of $200,000, indeed as high as $400,000.[9]

Based on the cost estimates of their consultants, the Interested Parties advocate that the Board use a Full-SAC litigation cost of $4.5 million, which is at the low end of Mr. Crowley's total cost estimates, to calculate the eligibility threshold between Full-SAC and the Three-Benchmark approaches. If the Board should adopt SSAC over the Interested Parties' objections, it should use a litigation cost of $3.5 million to calculate the eligibility threshold between SSAC and the Three-Benchmark approaches, which is the high end of the Interested Parties' consultant estimates, because of the tremendous uncertainty that surrounds both the process and application of the SSAC approach. As discussed further below, the actual eligibility thresholds should be calculated by multiplying these litigation cost estimates by a risk factor of three, which would

7 *Id.*
8 Fauth Opening V.S. at 6.
9 *Id.* at 46; Crowley Opening V.S. at 14.

result in a Full-SAC threshold of $13.5 million and an SSAC threshold, if SSAC is adopted, of $10.5 million.[10]

The Interested Parties expressly link these eligibility thresholds with elimination of the aggregation rule and the adoption of "case-specific" MVCs discussed further below. After the Board has developed some experience with simplified cases, it can reevaluate the eligibility thresholds, if necessary, to reflect actual experience.

2. **<u>Railroad criticisms of the Interested Parties' litigation cost estimates are unfounded and misleading.</u>**

The railroads' primary criticism of the Interested Parties' case cost estimates is that, since the proposed SSAC rules place certain data production burdens on the railroads, the shippers will be relieved of the costs of producing or generating such data themselves. This claim has been addressed previously by the Interested Parties and shown to be unpersuasive, and is addressed again by Witness Fauth in his Rebuttal Verified Statement.

Data production by a defendant railroad does not relieve a complainant of the need to verify the thoroughness and accuracy of the data or reduce the costs to apply the data to the case at hand. The Board would not expect railroads to blindly accept whatever facts are proffered to them by shippers in the course of litigation, and should not demand similar blind reliance by shippers on data produced by railroads. Independent data collection and verification is very nearly as costly as developing data through discovery. Placing certain data production burdens on defendant railroads may be appropriate to help expedite a case, but it will not necessarily produce a significant reduction in litigation costs.

Rather than having presented an irresponsible overstatement of costs, the Interested Parties' cost estimates are in fact conservative and understated in many areas. For example, Mr.

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10 These numbers approximate the eligibility boundary for SSAC suggested by the United States Department of Agriculture in its Opening Comments.

Fauth's estimates exclude travel, document reproduction, and all other out-of-pocket costs which easily can reach mid five-figure range. Moreover, many shippers who are candidates for "simplified" cases will have had little or no experience with regulatory litigation and a cost consultant will need to lead them through each step in the process of gathering, producing, and analyzing relevant data from their own files.[11]

Union Pacific is alone among the railroad parties in taking issue with specific elements of the cost consultants' time estimates to prepare an SSAC case. UP distorts the Interested Parties' evidence by arguing that the shipper "consultants would spend 324 to 744 hours – the equivalent of 50 to 93 eight-hour days – calculating variable costs using the Board's URCS Phase III methodology." UP Reply at 32. However, an examination of the components of the shippers' cost estimates (i.e., Appendix GWF-2 to the Opening Verified Statement of G. W. Fauth, III) indicates that UP has misinterpreted the evidence provided by Mr. Fauth, the consultant who itemized the time estimates. For example, at page 33 of its Reply, UP indicates that it included in its claim the time allocated by Mr. Fauth for "data collection, research and evaluation of the issue movements." But that time is not time to be devoted strictly to URCS Phase III issues, as erroneously claimed by UP. In fact, a review of Mr. Fauth's time flow chart (Fauth, Opening V.S., App. GWF-2) has only two line items earmarked for URCS Phase III studies and those two items range from a low of 80 to a high of 200 hours, or roughly one-third of the URCS-related time mistakenly identified by UP as URCS Phase III time. See Fauth R.V.S. at 10. If the time allocated by Mr. Fauth to analyze URCS Phase III data were reduced by one-half of the Phase III URCS time Mr. Fauth estimated, a total of 40 hours would be removed from the low end of the Fauth time chart and 100 hours from the high end, resulting in a consultancy cost estimate reduction in Mr. Fauth's numbers of $7,000 at the low end and $17,500 at the high end. In other

11 Fauth R.V.S. at 11 and 12.

words, even crediting UP's meritless claim that Mr. Fauth targeted too much time for URCS Phase III work, his estimated consultancy costs would barely be reduced.

Any boundaries drawn by the Board between Full-SAC and "simplified" procedures must be based on realistic, supported cost estimates and not conjecture. The Interested Parties have met that burden, as well as it can be met at this time. The railroads have not. Notably, four of the commenting carriers – BNSF, CSX, NS, and UP – have been defendants in Full-SAC cases and easily could have testified about the time and expense they devoted to the defense of those cases. Such testimony might have provided a barometer by which to measure the reliability of the Full-SAC cost estimates of the shipper consultants and thus the reliability of other shipper cost estimates. The carriers, however, chose to avoid any such comparison, giving rise to an inference that their own litigation expenses would confirm those identified by the shipper cost consultants.

AAR points to the Comments of Snavely, King, Majoros, O'Connor & Lee, Inc., as evidence that Three-Benchmark cases can be pursued for as little as $50,000. AAR Reply at 7, n. 7. The Snavely, King Comments, however, do not support that conclusion; they instead present the negative postulate that it is "unlikely … that [Three-Benchmark] cases could be pursued fully for less than $50,000 in consulting and legal fees." This is a far cry from a claim that a Three-Benchmark case can be presented for *only* $50,000.

Finally, the Interested Parties must respond to the claims of BNSF and its Witness Klick that "any significant expansion of the eligibility criteria for the three benchmark standard would subject an inappropriately large portion of BNSF's traffic to rate regulation under standards that have only a tenuous connection to [constrained market pricing]." BNSF Reply at 7. BNSF does not define what it means by "an inappropriately large portion" of its traffic. Witness Klick states that, were the $1.6 million cap on a Three-Benchmark case advocated by USDA to be applicable, 49 percent of BNSF's traffic would become subject to the Three-Benchmark approach and that, under the Board's proposed rules, 17 percent of its traffic would be subject to Three-Benchmark procedures.

However, those figures are based on all traffic with an R/VC ratio above 180%. That fact, however, does not automatically subject traffic to rate regulation, since there also must be a demonstrated absence of effective modal competition. That alone proves that BNSF's estimates are too high.

The question, however, is not whether BNSF would prefer to see a smaller segment of its traffic subject to challenge under Three-Benchmark procedures, but whether BNSF's rates are unreasonably high and must therefore be subject to the remedies provided by Congress. If a great majority of BNSF's traffic is market-dominant and many of those rates are unreasonably high, then a significant percentage of its rates should become subject to challenge under the Three-Benchmark or other unreasonable rate standards.

B. Risk Factors Must Be Considered.

The statutory standard of "too costly, given the value of the case" cannot be satisfied merely by a calculation of the direct consulting, legal, and out-of-pocket expenses to be incurred by a complainant. The Board is obligated to consider "cost" in relation to the "value" of the case. A rate complaint that, at best, will result in merely the return to the complainant of its investment in the case has no "value" whatsoever. To make litigation of this nature worthwhile, the value of the case has to involve a multiple of the complainant's actual costs.

The railroads refuse to recognize the validity of a risk factor to determine the value of a case. They claim that a risk factor amounts to speculation as to the probability of litigation success.[12] Among the carrier contentions is the claim that use of a risk factor in the eligibility process insulates the complaining party from the risks of litigation. The railroads have it backwards; the absence of any risk factor will insulate market dominant railroads from the risk of litigation because there won't be any. Although a risk factor recognizes that litigation often is unsuccessful, in whole or in part, it does <u>not</u> require the Board to predict the likely degree of success in any given case. Rather, a risk factor is necessary to avoid an outcome where the value of a complainant's recovery would not justify the costs of even the most meritorious litigation. Thus, a risk factor is essential to determine whether Full-SAC is "too costly given the value of the case."

The validity of this very conclusion was recognized by the Board when it adopted the current simplified guidelines:

> As shippers point out, a SAC presentation would not be cost-effective unless the value of the expected remedy exceeds the expected costs of obtaining the remedy by a sufficient margin to make it worthwhile to pursue the complaint. If the costs of pursuing a complaint would consume most or all of the expected recovery, then the remedy would be a hollow one for the complainant.

Simplified Guidelines, 1 S.T.B. at 1049. The Board's conclusion that a case that consumes "most or all" of the Board's award is a "hollow one" is just as correct now as it was when originally made. A case has no value if the expected recovery is wholly, or even mostly, consumed by the costs. Since the Board itself already has recognized the necessity of applying a risk factor to determine eligibility to use the current simplified rules, the only question is the margin above litigation cost recovery that should be used.

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12 UP Reply at 61; AAR Reply at 11; BNSF Reply at 10; CSX/NS Reply at 11. UP argues that shippers are themselves responsible for litigation risks by relying on "overreaching" arguments that are rejected by the Board. UP's arguments make it clear that UP and other railroads oppose use of a risk factor in determining case value as a means of forcing shippers to take the most conservative possible stance in rate litigation, with no comparable constraint upon the railroads.

The Interested Parties have previously suggested a risk factor of three; that is, if the cost of bringing a Full-SAC case is, say, $4.5 million, a risk factor of three would require the case to have a value of $13.5 million to avoid a conclusion that the case would be "too costly." A multiple of three was advocated by the shipper interests because it is clear that "a sufficient margin to make it worthwhile to pursue the complaint" cannot be achieved by a risk factor margin of as little as two. Looking at the outcomes of Full-SAC litigation – the only reference point for any rate litigation – indicates that shippers have not prevailed more than half the time over the past five years. A prudent manager would not, therefore, be likely to invest substantial sums in litigation without an expectation of recovering more than twice the cost of litigation because of the real possibility that there will be no recovery in more than half the cases brought.

The Board's failure to include a risk factor in its eligibility standards is impractical, contrary to its own findings, and incorrect. A risk factor of three times a realistic cost estimate should be recognized.

C. <u>The Board's Maximum Value of the Case Approach Must be Revised.</u>

The maximum value of the case ("MVC") analysis determines whether a given case qualifies for SSAC or Three-Benchmark treatment. The Decision states that MVC is calculated by multiplying the difference between the challenged rate and the jurisdictional floor by the annual volume of traffic at issue, discounted to present day value. Put somewhat differently, MVC as defined in the *Decision* assumes that every rate complaint will result in a prescribed rate of 180 percent of variable cost, an assumption that is totally unrealistic.

Recognizing that the Board's MVC assumptions are unrealistic and unsupportable to the extent they rest on the assumption that all rate complaints will result in rates at 180 percent of variable costs, some railroads offer an alternative election for complainants. The carriers suggest that a complainant can select a revenue/variable cost ("R/VC") ratio in excess of 180 percent to use for MVC calculation purposes provided that the same ratio becomes the upper ceiling of the R/VC ratio used to prescribe a maximum rate if the shipper otherwise prevails. Additionally, the carriers insist that any such election by the shipper be tied to the "aggregation rules" proposed by the Board, as discussed below. *See* UP Reply at 58; AAR Reply at 11-12; BNSF Reply at 10-11; CSX/NS Reply at 9.

The Interested Parties have taken the railroads' proposals seriously. At the very least, the proposals acknowledge the weakness in the Board's approach. However, the Interested Parties believe that the proposals are inadequate under the terms offered by the carriers. Counsel for the Interested Parties met with counsel for AAR, CSX/NS, BNSF and UP to explore the carriers' position and the shippers' concerns, but were unable to reach any definitive agreement.

In essence, the railroads are proposing that a complainant not be bound by use of a 180 percent R/VC factor for MVC purposes if the complainant is willing to make an uninformed guess at a higher R/VC ratio that might evolve in the case. Complainants, however, have no informed basis on which to project a meaningful R/VC ratio, even though it is a virtual certainty that no case will result in the actual use of a 180 percent R/VC ratio for rate prescription purposes.[13] The option proposed by the carriers will be too close to a blindfolded "pin the tail on the donkey" approach unless there is a solid basis on which the complainant can project a probable case outcome and, therefore, a controlling R/VC ratio.

[13] No recent Full-SAC case has produced an ultimate R/VC ratio of 180 percent. Accordingly, it is not realistic to expect that an SSAC case can do so, especially under the Board's proposal that a simplified stand-alone hypothetical rail system not be required to operate efficiently. Similarly, no Three-Benchmark case can result in a rate as low as 180 percent of variable cost, even if the defendant railroad has achieved revenue adequacy, because the confidence interval requirement for the proposed comparability aspect of the Three-Benchmark test assures that all final rates will be over 180 percent of variable costs.

That path is blocked, however, principally by the shippers' inability to gain pre-complaint access to the costed waybill file and any access whatsoever to unmasked waybill data, both of which are essential to utilize fully the "comparability" element of the Three-Benchmark test. Selection of an R/VC ratio for MVC purposes that is only marginally above 180 percent would have little impact on the MVC, while selection of one that might have a discernable MVC impact could end up depriving the shipper of rate relief to which it is plainly entitled. For example, were the shipper to arbitrarily choose an R/VC ratio of 250 for MVC purposes, and the case were to end up otherwise justifying an R/VC of 230, the shipper would be foregoing rate relief for no purpose other than to cope with the Board's flawed MVC approach. Much of the controversy over MVP would be obviated if the monetary boundaries for simplified cases were raised substantially, as proposed by the Interested Parties.

Also not to be overlooked is the carriers' insistence that their proposed MVC option be tied to the Board's aggregation rules in Three-Benchmark cases. Because the aggregation rules produce unlawful results, the Interested Parties cannot accept the railroads' MVC proposal on the railroads' terms.

The Interested Parties would not oppose making available to complainants an <u>option</u> to use an R/VC ratio higher than 180 for MVC purposes as a "case-specific" MVC. In order to make the option useful, however, shippers must have access to the data that is necessary to make an informed estimate of their MVC.[14]

[14] In addition, as the Interested Parties stated in their Opening Comments, the "case-specific" MVC should cap relief in the aggregate over the entire 5-year prescription period, as opposed to each year individually. For example, if a shipper's annual traffic volumes are higher for Year 1 and lower for Year 2 than estimated in its MVC calculation, the surplus volume in Year 1 would be offset to the extent of the deficit volume in Year 2, and so on up to the MVC.

D. **The Proposed Aggregation Rule is an Unlawful and Unnecessary Constraint Upon Eligibility.**

The Board has proposed that the $200,000 ceiling on Three-Benchmark recovery over five years apply to all traffic originating at a complaint origin or terminating at a complaint destination that moves via a common defendant, whether or not the complaining shipper has chosen to include all jurisdictional traffic in its complaint.[15] If a complaining shipper does not voluntarily aggregate its traffic in that manner, proceeds to file a Three-Benchmark complaint against a single rate from a single origin to a single destination, and recovers, say, $100,000 as the measure of unreasonably high rates, the shipper would be barred for a period of two years from recovering more than an additional $100,000 on any shipment moving from the same origin or to the same destination. This "aggregation" principle would apply, according to the *Decision*, to shipments moving from a common origin over totally different routes, to shipments involving different commodities, and to shipments involving different rates and rate structures.

The Board claims that this type of rule is necessary to "discourage a shipper from manipulating the MVC of the case." *Decision* at 34. Basically, the carriers agree, although CSX and NS recognize that the aggregation rule may go too far, as discussed below.

There are several flaws in the Board's reasoning. First, the statute requires that use of simplified procedures be tied to a specific Full-SAC presentation. That is, a "simplified" case, including one under the Three-Benchmark test, cannot be deemed "too costly" except in relation to a specific Full-SAC case. If a shipper would rationally bring a Full-SAC case only with respect to shipments of a specified commodity from point A to point B, then a determination of whether a simplified proceeding would be too costly would have to be measured against the value of that particular SAC case.

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[15] This same restriction also would apply to SSAC, with similar consequences to those arising under Three-Benchmark.

The proposed aggregation rules, however, go far beyond that principle and require a shipper to aggregate into a single Three-Benchmark case all of its shipments from a common origin via a common defendant, even if those shipments would never rationally be included in the same SAC case.

CSX and NS suggest that the Board has not proposed a "rigid" aggregation rule, but merely a rebuttable presumption. CSX/NS Reply at 8. However, even subjecting the rule to a "rebuttable presumption" would not solve the problem, because the rule simply violates the statute by depriving a shipper of what the Board recognizes as a legitimate form of simplified relief that cannot be related to a corresponding Full-SAC case. Nor should the shipper be required to undertake the cost of overcoming a presumption to the contrary.

Further, the Board is incorrect in suggesting that it is in the interest of shippers to manipulate the Three-Benchmark process through a series of complaints where one complaint would do. Perhaps the Board anticipates such manipulation because it recognizes that the financial boundaries it has proposed for Three-Benchmark cases are drastically low, and the Board expects shippers to seek devious alternatives. Of course, any such motives would disappear if the Three-Benchmark boundary is raised, as it clearly must be to comply with the statute. The costs and business distraction of multiple complaints are themselves a disincentive to manipulation of the process by shippers.

The extreme nature of the Board's proposal is shown by the fact that it even appears to include complaints against rates that may not have been in existence at unreasonably high levels at the time a shipper initiates its Three-Benchmark complaint from a given origin. A second rate from the same origin may be raised by the carrier after the initial complaint is filed, or even after the initial rate case has been decided. Yet the proposed rules could subject the shipper to aggregation limitations as to a new cause of action that could not have been foreseen when the first complaint was filed. Even if there were two unreasonably high rates in existence from a common origin, there might not be a commercial need for the shipper to challenge both at the same time.

Several of the opening comments filed by shipper interests pointed out that the proposed aggregation rules have the real potential to leave shippers without any remedy whatsoever because they may "use up" aggregated eligibility under the Three-Benchmark test with rate relief for only a relatively few carloads annually, and yet find it "too costly" to pursue any other form of relief. Not one railroad has denied that such an outcome is possible. In the Interested Parties' view, it is not only possible, but probable. And it is unlawful.

The Interested Parties suggest that the Board should abandon its aggregation rule, since it is highly unlikely that "manipulation" of access to the Three-Benchmark approach will occur at all, much less be significant. If actual experience should prove otherwise, the Board can then tailor appropriate relief. But, the Board should not set up additional hurdles to accessing regulatory protection, based merely on speculation, particularly when existing hurdles already have denied such access for over a decade.

IV. THE BOARD SHOULD FOCUS ITS EFFORTS ON REFINING THE THREE-BENCHMARK APPROACH.

Ever since the Board adopted the Three-Benchmark approach in *Simplified Guidelines*, shippers have asked for greater clarification and guidance in the application of the three benchmarks. The uncertainties that surrounded the Three-Benchmark approach created a chilling effect that, until very recently, had stifled any small rate case complaints. At last, a decade later, the Board has initiated this proceeding in response to those requests. However, instead of only providing the requested guidance, the Board has all but abandoned the Three-

Benchmark approach in favor of SSAC, an entirely new, more costly, more time consuming, and more complex approach that promises to be even more stifling than the Three-Benchmark approach. The Interested Parties strongly urge the Board not to be so quick to narrow the Three-Benchmark approach, but instead to focus its efforts upon further improving that approach.

A. The Board's Three-Benchmark Proposals Are A Substantive Improvement.

The Board's proposals for revising the Three-Benchmark approach are a significant step in the direction of providing much needed guidance and clarification on the substance of the test, although debilitating problems remain with the eligibility standards, as discussed above. At pages 32-33 of their Opening Comments, the Interested Parties commented positively on the Board's proposed correction of the flawed RSAM calculation, the use of unadjusted URCS, the adoption of "baseball syle" arbitration to select comparable traffic groups, and the streamlining of discovery. Although the Interested Parties believe a 180-day procedural schedule is attainable, and therefore preferable, the 240-day schedule proposed by the Board remains preferable to the uncertain and open-ended schedule that currently exists.

The Interested Parties, however, have noted several concerns with other aspects of the Board's Three-Benchmark proposals. First, the Board's proposed confidence interval is not calculated correctly and, in any event, it has no statistical basis because the comparison group is not a random sample. Interested Parties Opening Comments at 34. Although BNSF also objects to a confidence interval (albeit for different reasons), it nevertheless contends that it is irrelevant that the comparison group is not a random sample, since it is drawn from the Waybill Sample, which itself is random. BNSF Reply at 37. Using BNSF's logic, as long as some larger predecessor group were randomly drawn, a meaningful confidence interval could be calculated for any subsequent non-random selection from that group. This makes absolutely no sense. The

Interested Parties also note that, if a confidence interval is used, the comparable group must be greater than 30 because using a Student's t-distribution, as proposed by the Board, will not produce a 90% confidence interval when the population is not normal. Ultimately, a confidence interval serves merely to arbitrarily skew the results of the Three-Benchmark comparison upward.

In addition, the Interested Parties do not favor a strictly formulaic approach. Rather, they urge the Board to preserve the "landscape" approach that is available under the current iteration of the Three-Benchmark approach. Individualized factors can indicate that a rate determined to be reasonable under the formula may in fact be unreasonable. In addition, individualized factors are necessary to permit evidence concerning the statutory Long-Cannon factors. At least on the general merits of individualized factors, some railroads seem to agree with the Interested Parties. CSX/NS Reply at 26.

B. <u>The Board Should Reject Railroad Attempts To Establish Blanket Exclusions Of Traffic From The Comparable Traffic Group.</u>

Every railroad commenter contends that contract traffic is not comparable and should be excluded from the Three-Benchmark analysis. All of them, except CSX/NS, urge the Board to adopt a blanket exclusion of all contract traffic in its rules. *Compare* BNSF Reply at 35, UP Reply at 45, CPR Reply at 15 *with* CSX/NS Reply at 29, 31. At a minimum, those arguments should be made in the context of individual cases, not as a blanket rule.

The Interested Parties reject any notion that contract traffic is never under any circumstances comparable to tariff traffic. The railroads themselves seem to draw few distinctions between the two. As the Board is well aware, there increasingly is little or no difference in the service provided between tariffs and many contracts. Although contracts may contain volume commitments, those contract commitments don't necessarily result in the shipper tendering less traffic under a tariff, where the shipper is captive to the carrier anyway. Nor do service commitments distinguish contracts and tariffs, since it is rare that a railroad will sign a contract today that has an enforceable service obligation above and beyond the "reasonable dispatch" obligation of a common carrier tariff movement. Increasingly, in the declining number of instances where railroads are willing to enter into new contracts, they are for very short terms, so that the carrier can change its rates as often as it changes tariff rates. Also, contracts frequently look like tariffs and/or incorporate tariffs wholesale into their contracts. At the very least, these facts indicate that a blanket prohibition on contract traffic is unwarranted.

Contrary to the carriers' suggestions, the existence of a contract does not necessarily mean the existence of a negotiated or bargained rate. Some shipments that move under contract designations employ tariff rates and have been placed under contract for a narrow, special reason, such as a car supply commitment, demurrage, or storage, and do not reflect any type of negotiated rate. All of these types of contracts are indistinguishable from tariffs insofar as the applicable rates may be a measure of market conditions.

The railroads also ignore the fact that some shippers may request a tariff rate only after they are unable to obtain a reasonable rate in contract negotiations. The tariff rate is for the same commodity and typically for the very same service. From the shipper's perspective, the only thing that has changed is the rate source.

The railroads' argument that all traffic moving under contracts must be excluded from Three-Benchmark consideration also is inconsistent with the proposed rules themselves. Those rules contain a process for determining a traffic group comparable to the issue traffic. At the conclusion of that process, after the Board has selected the comparable traffic group, the rules provide that the Board will then utilize unmasked revenues from that group to determine a maximum reasonable rate. *See Decision* at 33. As the railroads point out in their Replies, the reason for using masking factors in the waybill sample is to shield from public view contract revenues that the railroads have chosen to conceal through the use of the masking factors. Thus, by its proposal to use unmasked revenues to determine a reasonable rate, the Board has acknowledged that contract movements are in fact appropriate for inclusion in comparability groups. The Board should adhere to that view and reject the railroads' call for the blanket exclusion of shipments moving under contract from the Three-Benchmark process.

UP and BNSF also advocate the exclusion of traffic not carried by the defendant railroad. UP Reply at 48-49. The Interested Parties responded to those arguments at pages 21-22 of their Reply Comments.

There is no good reason for any blanket restrictions on the comparable traffic group. Each party should raise any objections to traffic on an individual basis in each case.

C. <u>Access To Unmasked Confidential Waybill Data Is Essential.</u>

Fundamental fairness mandates that complainants be granted access to the unmasked confidential waybill data in a Three-Benchmark case. The railroads contend that shippers do not need access to unmasked data because comparability does not depend on the rate. AAR Reply at 15-16; CSX/NS Reply at 28-29. The Joint Commenters do not agree that rate comparisons are irrelevant to comparability comparisons. But, whether or not this is true, access to the waybill is about the fairness of the process and consistency.

Although there will be some traffic that clearly is comparable and other traffic that clearly is not, there will always be a substantial grey area in the middle where most of the disagreement regarding comparability will occur. Thus, even accepting the argument that rates are irrelevant to comparability, there <u>is</u> an advantage to knowing the rate in deciding whether to advocate for or against the inclusion of certain grey area traffic in the comparable group.[16] The railroads will have access to this information because they know what rates are hidden by their own masking factors, but the shippers will not. This places shippers at a fundamental disadvantage to the railroads from the outset of any Three-Benchmark case.

The railroads contend that they possess no advantage over shippers because the "baseball" style selection of comparable traffic imposes risks on them if they select traffic on the basis of R/VC ratios. But that argument completely misses the point. The railroad advantage comes not from selecting traffic solely on the basis of R/VC ratios, but from knowing which grey area traffic to expend their time and effort to support on the basis of other relevant factors, and which traffic to exclude. "Baseball" style selection actually exacerbates the disadvantage to shippers who unknowingly may advocate a non-advantageous traffic group, while there is no risk that the railroad would do so, since it knows the actual R/VC ratios of its traffic.

The railroad confidentiality arguments are a red herring. The masked waybill data is no more confidential than other data that railroads routinely must produce in Full-SAC cases and in merger proceedings. Indeed, the masked waybill rates themselves are revealed in contracts that railroads produce in every Full-SAC case. The same protective orders that preserve the confidentiality of that data in other cases will preserve it in a Three-Benchmark case.

Restrictions on access to the confidential waybill sample prior to filing a complaint also increase the expense of preparing a Three-Benchmark case. As Witness Fauth discusses at pages 12-13 of his Rebuttal Verified Statement, because railroad identification fields and specific location code fields are excluded from the public waybill sample, the identification of specific traffic is much more difficult and time consuming than it should be.

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16 The Board also has said that comparable traffic should have similar elasticities of demand. *Decision* at 20. To the extent that rates are indicative of elasticity, there also is an advantage to knowing the actual rate when selecting traffic for the comparable group.

Finally, as discussed more extensively in Part III.D., *supra*, access to the unmasked waybill data even before a complaint is filed will be necessary if shippers are to estimate their own "case-specific" MVC, rather than use the 180% jurisdictional threshold.

D. **Railroad Concerns With The Three-Benchmark Approach Are Overblown and Meritless.**

The principal railroad industry objection to the Three-Benchmark approach is that it is not CMP. While UP objects to using the Three-Benchmark approach under any circumstances, the other carriers accept it as appropriate, but only for the most microscopic of cases, with the result that no Three-Benchmark cases are likely ever to be filed. This severe restriction upon application of the Three-Benchmark approach seems to be premised on a belief that there will be a deluge of frivolous cases that will undermine the revenue adequacy of the rail industry. These concerns, which are not based on any facts, are overblown and without merit.

1. **The Three-Benchmark approach is consistent with the statute.**

First of all, as discussed extensively in Part I, *supra*, Congress did not mandate CMP for small rate cases. In fact, Congress mandated a simplified and expedited alternative method to CMP when a Full-SAC presentation is too costly given the value of the case.

The railroads rely heavily on *Burlington Northern Railroad Co. v. United States*, 928 F.2d 589 (D.C. Cir. 1993) for the proposition that Three Benchmark is inconsistent with the statute. However, that decision did not involve the Three Benchmark approach. In addition, the decision predated the ICCTA mandate for a simplified and expedited alternative, and it predated the Board's *Simplified Guidelines* decision. When the railroads sought review of *Simplified Guidelines*, the court found the railroads' challenge premature. *Association of American Railroads v. STB*, 146 F.3d 942, 947 (D.C. Cir. 1998).

Moreover, in *Simplified Guidelines*, the Board held that "[a]ccuracy must be sacrificed for simplicity...to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic." 1 S.T.B. at 1008. The Board also concluded that the Three-Benchmark approach "provide[s] an appropriate frame of reference for our rate reasonableness analysis [and] properly introduce[s] all of the factors that must be looked at in our analysis." *Id.* at 1020. Neither the Board nor the railroads have presented any basis to reconsider those holdings now.

2. The problem is not too many rate cases.

From the Opening and Reply Comments of the railroads, one might conclude that the principal problem with small rate cases is that there are too many of them, and that most such cases are frivolous. It is almost impossible to be farther from the truth. Nor is there any basis to conclude that continuing to employ the Three-Benchmark approach for all small rate cases will evolve into this scenario or that it will in any way threaten railroad revenue adequacy.

It is both premature and illogical for the railroads to contend that the Three-Benchmark approach will undermine railroad revenue adequacy if it is not narrowly confined to microscopic cases. The carriers support the Board's proposed eligibility rules, including the aggregation requirements, because they see the rules as insurance that very few cases will qualify for Three-Benchmark relief. The Interested Parties believe that the railroads' projection that a change in Three-Benchmark eligibility standards will produce a deluge of Three-Benchmark complaints and a massive revenue drain is unfounded. A relaxation of the Three-Benchmark boundaries by itself is highly unlikely to lead to the doomsday results projected by the carriers because the substantive numbers and outcomes of the Three-Benchmark process cannot be fully known at this time, and what is known suggests that the railroads' concerns are unfounded.

Specifically, in *Simplified Guidelines*, the Board "expressed confidence that reliance on [Three-Benchmark] would not significantly affect a carrier's overall ability to earn adequate revenues…," because most traffic would not even be eligible for rate regulation due to the market dominance requirement, contracts, and exemptions. 1 S.T.B. at 1008-09. The Board's analysis in Table 2 of the *Decision,* and the analysis of BNSF Witness Klick based on Table 2, do not consider these factors, and thus substantially overstate the amount of traffic that could use the simplified standards. It is important to note that the Board's observation in *Simplified Guidelines* was premised upon Three-Benchmark being the <u>only</u> approach to small rate cases. There is nothing in the Board's proposed refinements to Three-Benchmark that suddenly would vitiate this conclusion.

Since the Three-Benchmark approach was first adopted in 1996 for <u>all</u> small rate cases, there have been only two cases filed, the first of which quickly settled, and the second, which has just been filed and is headed towards mediation. Nor is it likely that the Interested Parties' proposed eligibility thresholds would result in a deluge of new complaints, since not every rate in excess of 180 percent of variable costs will result in a complaint, in part due to qualitative market dominance factors. Thus, there is no basis to the railroads' supposed fear of unduly large numbers of cases being decided by the Three-Benchmark approach, even at the higher eligibility thresholds urged by the Interested Parties.

Since small rate cases have been nonexistent for so long, it is absurd to suggest either that railroad revenue shortfalls in the 1980s were due to excessive rate regulation, or that progress toward revenue adequacy has resulted from STB decisions favoring railroad defendants in small rate cases. Rather, railroad revenue adequacy is a function of changes in the marketplace, including elimination of excess capacity and reduced competition. And if, for the first time ever, a shipper were to succeed in obtaining rate relief from the Board under simple and expedited procedures, there is no reason to believe that major railroads would not continue their progress toward revenue adequacy. However, the source of that progress might be more fairly balanced between captive and competitive shippers, as Long-Cannon requires.

Railroad claims of frivolous rate cases are another red herring. Rate cases filed by shippers with no chance of success are not just costly, but expose the shippers to the possibility of higher rates once challenged rates have been found reasonable. In any event, the Board can address claims of frivolous litigation tactics, by shippers and railroads, if and when they arise. Railroad arguments for deterring frivolous rate cases through measures that further increase barriers to captive shippers' recourse to relief are improper.

All shippers would continue to attempt good-faith negotiations with railroads, because under no scenario raised in this proceeding can any shipper be certain of rate relief. However, instead of negotiations in which only one party – the market dominant railroad – has any leverage, there would be the possibility of negotiations in which both sides might reach a mutually beneficial commercial agreement.

Even if the Board adopts the recommendations of the Interested Parties and other shippers in this proceeding and makes full use of Three Benchmark as the sole alternative to Full-SAC, litigious shippers should not be the Board's main concern. Rather, the Board should be concerned that its rate reasonableness procedures meet the Congressional mandate of a truly simplified remedy for a captive shipper constituency that has been subject to essentially unregulated railroad pricing for decades. Against this backdrop, accusations that the Interested Parties demonstrate undue "zeal for expanded rate regulation" (BNSF Reply at 4) cannot be taken seriously. The statute mandates reasonable rates for all captive traffic, and the fact that this mandate has gone unfilled for so long is a feature of the regulatory landscape that must be corrected, not preserved.

V. SSAC CONTAINS MORE COMPLEXITY AND UNCERTAINTY THAN EVER EXISTED UNDER THE THREE-BENCHMARK APPROACH.

Only in the past two years, as rail rates have risen dramatically over a short time period, have a few captive shippers been willing to brave the uncertainties of the Three-Benchmark approach by filing the first small rate cases. However, just when the Board has the opportunity to provide guidance in an actual small rate case, it has proposed an entirely new approach in SSAC that pulls the rug out from underneath shippers by adding complexity, time, and costs to small rate cases.

A. SSAC Is Not Consistent With CMP.

The railroads strongly support SSAC because they assert that it is consistent with, and is a reasonable simplification of, CMP. As demonstrated in Part II., *supra*, Congress did not mandate CMP for small rate cases. Just as significant, however, is the fact that the supposed simplifications of Full-SAC actually render SSAC inconsistent with CMP.

In their Opening Comments at pages 29-31, the Interested Parties demonstrated that SSAC, by eliminating the efficiency improvements of Full-SAC, violates CMP because it violates contestability, which is one of the two core economic theories underlying CMP. As BNSF observes, "The critical simplifying assumption of the Board's SSAC proposal is the assumption that the simplified SARR handles the same traffic as the incumbent over the same routes used by the incumbent." BNSF Reply at 18. By eliminating the complainant's right to select what traffic the SARR will serve and over what routes it will operate, BNSF argues that SSAC removes "the source of most of the complexity in Full-SAC litigation." *Id.*

But, in the process of removing that complexity, SSAC eliminates the complainant's ability to group traffic, which "is essential to [the] theory of contestability." *Guidelines,* 1 I.C.C. 2d at 544. "Without grouping, SAC would not be a very useful test, since the captive shipper would be deprived of the benefits of any inherent production economies." *Id.* The Board cannot gut an essential element of both CMP and Full-SAC in the name of simplification and then claim that the result remains consistent with CMP.

AAR characterizes the Interested Parties' objections as "a complaint about simplification itself." AAR Reply at 13. But, that argument is tautological. Because the simplification in SSAC does not in fact preserve CMP and will produce rates higher than CMP, the Interested Parties object to that simplification. It is not acceptable to adopt SSAC just because it is simplified; it still must preserve the essence of CMP to be consistent with CMP. To the extent that CMP is fair to both railroads and shippers, eliminating the fairness to shippers while retaining the fairness to railroads is not simplification, but distortion.

In *Simplified Guidelines,* 1 S.T.B. at 1012, the Board rejected an SSAC proposal because it was inconsistent with CMP and biased toward the railroads in its assumptions. Although the Board noted that the SSAC proposal in that proceeding "shares some important attributes of CMP-SAC," it also noted that the proposal "is inconsistent with CMP-SAC in two key respects which appear to distort the results in favor of the railroads." *Id.* at 1015. Because SSAC was not based on a fully efficient system, the Board concluded that it failed a basic purpose of CMP to determine the cost of an optimally efficient system. *Id. See also,* Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases,* at 41 (served Oct. 30, 2006) ("The carriers contend that the SARR would not have the opportunity to realize any efficiency gains because it would be an optimally efficient carrier at inception and thus would not face the inefficiencies of incumbent carriers."). The Board's currently proposed SSAC methodology suffers from a similar fatal flaw by requiring complainants to use the incumbent's existing traffic base, infrastructure, and URCS-based operating costs for the stand-alone railroad.

Thus, as in *Simplified Guidelines*, SSAC is clothed in the terminology of CMP, but lacks much of the substance that is essential to CMP. What the Board and the railroads refer to as a simplification is really a gutting of CMP. Consequently, SSAC bears no greater relationship to CMP than the Three-Benchmark approach, and most likely less. The Three-Benchmark approach, however, offers a simpler, less costly, and less time consuming alternative.

B. <u>The Board Has Not Tested SSAC To Determine That It Is Consistent With CMP.</u>

In *Simplified Guidelines*, the Board tested the proposed SSAC model to determine whether it did produce results consistent with CMP. *Id.* at 1016-17. Those tests revealed that the model generated absurdly high rates. But the Board has not performed any tests of its SSAC proposal in this proceeding, even though its proposal, like the one in *Simplified Guidelines*, also is not based on a fully efficient system. Witness Fauth explains the importance of testing SSAC, in response to various railroad comments, at pages 1-4 of his Rebuttal V.S.

Although the Board acknowledges that it rejected the SSAC approach in *Simplified Guidelines* because it was not based on a fully efficient system, it contends that times have changed in a way that requires a different outcome today. Specifically, the Board points to the existence of capacity constraints on today's rail network, contrasted with excess capacity in 1996. *Decision* at 11. *See also,* UP Reply at 13. But, neither capacity constraints nor excesses should be confused with efficiency. Although a railroad may not have excess capacity, that does not mean that its operations and infrastructure are optimally efficient. Indeed, capacity constraints can be due to inefficiencies. Moreover, capacity constraints are not pervasive on every rail line, as noted by the Board's adoption and application of the cross-subsidy test in *PPL Montana LLC v. The Burlington N. & Santa Fe Ry. Co.*, 6 S.T.B. 752 (2003), and *Otter Tail Power Co. v. BNSF Ry. Co.*, STB Docket No. 42071 (served Jan. 27, 2006) (discussing the impact of the test on shippers located on low-density lines).

Therefore, the risks of SSAC producing absurd results are just as high in this proceeding as they were in *Simplified Guidelines*. In the Interested Parties' Opening Comments, Exhibit 2 to the Verified Statement of Thomas D. Crowley presents a step-by-step exercise in logic to show how the simplifications in SSAC inevitably will produce higher rates than Full-SAC. The unanswered question is, how high? The railroads have not presented any evidence to refute the logic of that Exhibit.

Only one railroad has responded to the Interested Parties' call for testing of SSAC. But, UP asserts only that "Simplified-SAC requires no special testing because it is based on CMP and the SAC constraint." UP Reply at 40. That statement, however, is merely conclusory.[17] As demonstrated above, SSAC is missing the same essential element of CMP that was fatal to the SSAC proposal in *Simplified Guidelines*.

In light of the Board's experience with much higher SSAC rates in *Simplified Guidelines*, testing of SSAC is essential to determine how much higher SSAC would allow rates to increase over Full-SAC. The Board has most, if not all, of the data that it would need to conduct such tests by application to prior Full-SAC cases. Therefore, it would be arbitrary for the Board not to conduct tests of its SSAC proposal.

[17] The substance of UP's Reply Comments actually acknowledge that SSAC is not consistent with CMP. At note 41 on page 15, UP states that SSAC would evaluate "challenged-rates based on carrier's reasonable investments in infrastructure, rather than the investments that a new, optimally efficient entrant would hypothetically make if it could enter the market today." Consequently, SSAC is not even a simplification of Full-SAC, but adopts a standard that is very different from Full-SAC.

Finally, Interested Parties reiterate that the Board should not graft its new segment cross-subsidy test onto SSAC. The Board has proposed to make segment cross-subsidy an affirmative defense with railroads bearing the burden of proof, but this modification will not go far in protecting small and isolated shippers from abusive pricing over most, if not all, of the routes they must use. Rather, segment cross-subsidy claims by railroads can be expected as standard motions to dismiss in SSAC cases. The Board should reconsider its theory that if a shipper is on even a short low density line, as many small and non-coal shippers are, the railroad should be able to charge whatever it likes for the entire movement. Disqualifying most isolated shippers from any effective recourse is not what Congress intended in Section 10701(d).

VI. RAILROAD FINANCIAL NEEDS CANNOT JUSTIFY INEFFECTIVE STANDARDS FOR SMALL RATE CASES.

In their comments, the railroads state repeatedly that the Board must, above all else, avoid interfering with their ability to charge "market based" prices on their captive traffic, so that they can improve their financial strength and make the infrastructure investments needed to meet increasing freight volumes. *See, e.g.,* AAR Reply at 6; BNSF Reply at 4; UP Reply at 5; CSX/NS Reply at 6. If addressing this imperative means limiting recourse in small rate cases to an inferior form of Full-SAC, notwithstanding Section 10701(d)(3), that is the price the railroads would have captive shippers pay. Such arguments are riddled with flaws.

A. "Market Pricing" Does Not Establish Reasonable Rates In A Monopoly Market.

The railroads attempt to portray supply and demand as the sole reason for high rates, which they characterize as "market pricing." But, they employ the term "market pricing" misleadingly. Moreover, they wrongly accuse shippers of seeking insulation from competitive forces. AAR Reply at 5. Although the railroads' statements might deserve some credence where they operate in a competitive market, these concepts are of little help where captive shipper demand is inelastic and railroads control the supply of services.

When railroads speak of market pricing for captive traffic, or of charging what the market will bear, they are, as a matter of law and economics, referring to monopoly pricing. Since it is generally in the interest of monopolies not to drive their captive shippers out of business, they attempt to set rates at profit-maximizing levels by curtailing supply. This is why monopolies are deemed to be economically inefficient. The potential for monopolistic abuse is particularly acute when demand is greater than capacity, because railroads may use pricing to disfavor what they consider to be superfluous origins, such as 26-car and 52-car grain elevators.

The statute defines market dominance, and hence the possession of monopoly power, as "the absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies." "Effective competition," in turn, is competition that effectively restrains rail rates. As the court of appeals explained in *Arizona Pub. Serv. Co. v. United States*, 742 F.2d 644, 650-51 (D.C. Cir. 1984):

> At the core of the "effective competition" standard is the idea that there are competitive, market pressures on the railroads deterring them from charging monopoly prices for transporting goods.... At some point the availability of an alternative such as the horse and buggy or even people carrying oil in buckets theoretically prevents the railroads from raising their rates beyond some outer bound. But the mere existence of some alternative does not in itself constrain the railroads from charging rates far in excess of the just and reasonable rates that Congress thought the existence of competitive pressures would ensure.

In considering how to implement the statutory command of rate reasonableness for captive shippers for whom Full-SAC is prohibitively costly, the Board is by definition considering rail rates charged by market dominant railroads, i.e., rail rates for which there is no effective competition. To claim that these rates should somehow be deemed "reasonable" because they are market-based is specious.

B. <u>The General Need For More Rail Infrastructure Should Not Define The Standard For Small Rate Cases.</u>

The railroads apparently recognize that their claims of revenue inadequacy have lost or are losing their credibility, and that the Board will soon be required to grapple with the implications of revenue levels that are not just at, but well above, revenue adequacy. Their response appears to offer a new rationale for differential pricing – the need for infrastructure investment. *See* UP Reply at 15. But as explained at pages 4-7 of the Interested Parties' Reply Comments, railroad revenue needs for investment cannot override the statutory requirement of reasonable rates.

These Interested Parties do not deny that railroads will need capital to fund any infrastructure investments they make. However, the issue presented in this proceeding is the extent to which railroad revenue needs can lawfully be funded through differentially higher rates on *captive* traffic. That question was answered in *Guidelines*, where revenue adequacy was identified as the point at which further differential pricing would no longer be allowed.

The ICC noted that revenue adequacy is "the revenue level necessary for a railroad to compete equally with other firms for available financing in order to maintain, replace, modernize and, where appropriate, expand its facilities and services." *Guidelines,* 1 I.C.C. 2d at 535. Once revenue adequacy is achieved, railroads can readily obtain financing in the capital markets (or can more readily do so, since railroads have been able to raise money on Wall Street for years).

Guidelines goes on to state (*id.* at 535-36):

> Carriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues.... In other words, captive shippers should

> not be required to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs.[36/]
>
> [36/] A railroad seeking to earn revenues that would provide it, over the long term, a return on investment above the cost of capital would have to demonstrate, with particularity: (1) a need for higher revenues; (2) the harm it would suffer if it could not collect them; and (3) why the captive shippers should supply them.

BNSF's argument (Opening Comments at 41) that captive traffic is "the only traffic from which it is reasonable to expect that a railroad could obtain the higher level of contribution necessary to achieve revenue adequacy," is nonsense. Much of the railroad industry's current improving financial strength is due to higher rates on traffic moving at rates below 180% of variable cost. In any event, BNSF's argument ignores the Long-Cannon provisions of 49 U.S.C. § 10701(d)(2), under which the Board must consider whether market dominant railroads are doing enough to maximize revenues from low-rated traffic, and whether railroad revenue needs are being fairly allocated among commodities. As the Board recognized in *Major Issues in Rail Rate Cases*, slip op. at 16, "a railroad should recover as much of its costs as possible from each shipper served before charging differentially higher rates to its captive shippers."

Railroads may make some investments in new capacity (as differentiated from normal maintenance, equipment, and other ongoing infrastructure measures) aimed at attracting new business. But if they do so, their expansion of capacity cannot be funded disproportionately by captive shippers, who may not benefit commensurately, or at all, from such investments.

If the railroads want to increase rates to pay for infrastructure investments, one way they can and should do so is through contracts. Contracts permit railroads to combine rate increases with service improvements to identifiable beneficiaries.

As recognized even before the Staggers Rail Act of 1980, rail transportation contracts have significant benefits. "These benefits flow principally from the increased certainty inherent in contractual agreements and the resulting ability of both shippers and carriers to better plan allocation of their resources." *Change of Policy, Railroad Contract Rates*, 361 I.C.C. 205, 206 (1979). *See also Guidelines* at 556-58, explaining that contracts can lead to outcomes preferable to those produced by Ramsey pricing, and *Parrish & Heimbecker, Inc.–Petition for Declaratory Order*, 4 S.T.B. 866, 870 (2000) ("The authority to contract was one of the more significant aspects of the new freedoms granted by the Staggers Act because it allowed rail carriers to tailor rail services more individually and thereby market transportation services more effectively.").

Unfortunately, the trend among railroads appears to be away from the use of long-term or even short-term contracts. The railroads evidently prefer the ability to raise rates whenever they like in a non-contract context, partly because they do not regard STB rate regulation as likely to produce any relief for captive shippers.

Neither the facts, nor the law, nor sound economics or policy support railroad claims that their financial condition warrants second-class status for complainants in small rate cases. Nor can the Board lawfully use an inferior rate reasonableness methodology, excessively restrictive eligibility standards, or techniques like the "confidence interval" to accomplish indirectly what it could not do directly. Captive shippers in small rate cases have a statutory right to reasonable rail rates, and to rate reasonableness procedures that are as effective as Full-SAC even if they are "simplified and expedited."

In addition, as the railroads approach and achieve revenue adequacy, <u>all</u> captive shippers, regardless of whether Full-SAC is cost-justified or prohibitively expensive, are entitled to relief from excessive differential pricing. Simplified SAC as proposed by the Board not only falls short of meeting these goals, but actually makes their attainment more difficult.

It has long been the law that rail rates "may be unreasonable even if the carrier is far short of revenue adequacy." *Guidelines* at 536. It would turn this principle on its head to hold that capacity constraints permit revenue adequate railroads to charge rate levels that even revenue inadequate railroads could not lawfully charge. Indeed, if supply and demand or any other factors are allowing railroads to charge higher rates across the board, there is less reason, not more, for railroads to charge significantly higher rates on captive traffic, and STB rate reasonableness policy should reflect this fact.

VII. CONCLUSION.

For the most part, the Interested Parties have focused on the pros and cons of the Three Benchmark and SSAC proposals, along with crucial eligibility issues. But, they also urge the Board not to overlook the larger context in which this important proceeding arises, and to bear in mind a number of fundamental truths the railroads would have the Board ignore.

The railroads' arguments are entirely consistent with their desire to operate as unregulated or minimally regulated monopolies vis-à-vis captive shippers. While this preference is understandable from their perspective, the railroads' interests are not necessarily equivalent to the public interest, and the regulatory model the railroads prefer is not consistent with the letter or spirit of the Act.

Captive shippers are, by definition, rail-dependent shippers. Therefore, it is not in the interest of these Interested Parties or of other captive shippers to harm the railroads. But, it also is not in our interest to be harmed by the railroads. Rather, Interested Parties seek a balance between railroad pricing flexibility and reasonable rates for captive shippers that, for decades, has been promised by Congress. The Board now needs to deliver on that promise.

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Dated: January 11, 2007

REBUTTAL VERIFIED STATEMENT

OF

GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (GWF), an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. A detailed statement describing my background and experience was attached as Appendix GWF-1 to my Opening Verified Statement in this proceeding dated October 24, 2006 (Opening VS).

I have been asked by Counsel for a group of trade associations and other interested parties, referred to herein as the Interested Parties,[1] to prepare these rebuttal comments in response to comments submitted by Association of American Railroads, (AAR), BNSF Railway Company (BNSF), Union Pacific Railroad Company (UP), Norfolk Southern Railway Company (NS), CSX Transportation, Inc. (CSX) and other parties in Surface Transportation Board (STB or Board) Ex Parte No. 646 (Sub-No.1), Simplified Standards for Rail Rate Cases.

SSAC TESTING REQUIRED

In my Opening VS, I stressed that the STB has not provided the results of any testing to certify that its proposed new Simplified-SAC (SSAC) procedure will produce realistic results and protect captive shippers from paying unnecessarily high

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[1] These parties are identified in the Joint Written Comments submitted by Counsel Nicholas J. DiMichael and Andrew P. Goldstein in this proceeding on October 24, 2006.

rates.[2] The Railroads virtually ignore this important requirement for adequate testing of the STB's proposed SSAC procedure. The AAR, BNSF, CSX, NS, CN, CP and KCS make no mention of testing. UP merely states that "Simplified-SAC requires no special testing because it is based on CMP and the SAC constraint."[3]

As indicated in my Opening VS, the STB's proposed Simplified-SAC procedure represents a major departure from a basic premise of the STB's CMP framework, i.e., Full-SAC is based on hypothetical and *optimally efficient* stand-alone transportation system, whereas Simplified-SAC is based on the replacement of *existing* facilities.[4] SSAC includes many other deviations from the established SAC constraint. For example, the Board has proposed the use of Class I system average URCS costs to determine the operating expenses associated with the Stand Alone railroad (SARR), which would not reflect the optimally efficient operating characteristics of the SARR under the Full-SAC approach. The potential economic impact associated with these proposed departures from CMP and Full-SAC should be carefully tested and evaluated *before* the proposed SSAC procedures are formally adopted by the Board.

Since the STB has proposed this Simplified-SAC procedure, the STB should be responsible for adequately testing its proposed approach to ensure that it will produce realistic results and protect captive shippers from paying unnecessarily high rates. As indicated in my Opening VS, there is no discovery allowed in this rulemaking proceeding, therefore, it would be difficult for any outside independent consulting firm without access to internal railroad information and data to apply and test the STB's

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[2] See, e.g., page 34, Subsection 13. <u>STB Simplified-SAC Testing Required</u>.

[3] UP Reply, page 40.

[4] Opening VS, e.g. page 7.

proposed new Simplified-SAC procedure against sample movements in a way that would yield accurate results.[5]

The Railroads maintain the SSAC "would produce fair results" and would not be "biased against shippers."[6] They state that the Board's proposed SSAC procedure "generally reflects reasonable trade-offs between cost and accuracy."[7] These claims are pure and mere speculation. The Railroads offer absolutely no evidence to show that SSAC is consistent with CMP, would produce fair and unbiased results, or that the "trade-offs" between cost and accuracy are reasonable.

Since the Railroads generally support the STB's proposed SSAC approach (with certain modifications), and since they maintain the data necessary to test the Board's proposals and their proposed modifications, they may have already conducted such testing and perhaps could have presented such testing to the Board.

For example, Railroad Witness John C. Klick has been involved in numerous SAC cases and was involved in the development and testing of the AAR's previously proposed and rejected SSAC approach. Mr. Klick could have been provided the necessary data from his railroad clients to prepare and submit to the STB such testing of the Board's proposed SSAC approach. However, Mr. Klick's testimony is silent on the subject of testing. He maintains that the STB's proposed SSAC approach is a "reliable standard" and merely offers his unsupported belief that "there is no reason to believe such a simplification is systematically biased against shippers"[8]

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5 Opening VS, page 36.

6 UP Reply, page 11 and 12.

7 *Ibid.*, page 12

The reasons for the Railroads' failure to adequately address this issue are clear. Like AAR's previously proposed and rejected SSAC approach, STB's proposed new SSAC procedure is likely to produce maximum reasonable rates which would be significantly higher than the results determined by STB in previous SAC cases, in which case STB's SSAC may well turn out to be something vastly different from the standard it is portrayed to be in the Decision.

ESTIMATED LITIGATION COSTS ASSOCIATED WITH STB'S SIMPLIFIED-SAC

In my Opening VS, I estimated that economic consulting fees in a SSAC case could range from approximately **$500,000 to $1.25 million**, excluding legal fees. Included as Appendix GWF-2 to my Opening VS is a detailed estimate of the consulting work and costs associated with STB's proposed Simplified-SAC procedure. Appendix GWF-2 identifies six (6) Phases and sixty-two (62) individual work elements that would be associated with a SSAC proceeding. Based on my experience in the actual preparation and development of URCS costing and other evidence and testimony in railroad rate reasonableness proceedings, I developed estimates of the consulting hours that would be required for each of these 62 individual work elements. Based on the total itemized estimated hours that I developed, I concluded that the estimated consulting fees would range from $500,000 to $1.25 million, before legal fees and out-of-pocket expenses.[9]

UP maintains that the detailed estimates that I developed are overstated. Although UP presents no detailed estimates of its own, it maintains that SSAC should

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8 Klick Reply VS, pages 17 and 18.

9 Appendix GWF-2, page 4 includes estimates of $555,100 and $1,288,700 which I rounded down to be conservative.

cost a shipper significantly less than the Board's estimate of **$200,000.**[10] BNSF does not specifically criticize my estimates nor does it present any cost estimates of its own. It merely maintains that the Board's $200,000 figure is a "reasonable approximation" of the costs under a "steady state" environment.[11] CSX, NS and AAR do not specifically address my cost estimates, but maintain that the Board should not increase the proposed $200,000 level.[12]

STB's $200,000 SSAC Estimate is Primarily
Based on AAR's Previously Rejected SSAC Approach

The Board's $200,000 estimate was primarily developed from testimony submitted by railroad witnesses over a decade earlier in Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings. In that proceeding, Witnesses Craig F. Rockey and John C. Klick estimated that it would be possible to conduct AAR's Simplified-SAC presentation for between $25,000 and $85,000.[13] The STB apparently accepted and then increased these railroad estimates to reflect the "cost of counsel to litigate the case" and inflation.[14]

There are significant and serious problems with the Board's and Railroads' reliance on the estimates previously submitted by Witnesses Rockey and Klick in Ex Parte No. 347 (Sub-No.2). First, their outdated estimates relate to the Simplified-SAC approach that was previously proposed by the AAR and not the STB's proposed

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10 UP Opening, page 50 and UP Reply, page 27.

11 BNSF Witness Klick, page 8.

12 AAR Reply, page 8 and CSX/NS Reply, page 14.

13 NPRM, page 36

14 *Ibid.*

SSAC procedure. Although AAR's and STB's approaches may share the same name, i.e., Simplified-SAC, they are very different approaches. As such, the costs litigation costs associated with the two approaches would be very different.

AAR's Black Box Approach

AAR's SSAC approach was considered and known as a "*black box*" approach under which various movement inputs, such as origin, destination, miles, cars per train, etc., would be entered into AAR's proprietary computer program and SSAC results would be generated. Although the AAR's proposed SSAC approach was relatively simple to use, it produced inordinately high numbers under which a rate producing revenue-to-variable cost ratio levels of 5,000% would be considered reasonable. Thus, it was subsequently rejected by the ICC and STB.

Under the AAR's previously proposed and rejected "black box" SSAC approach, professional consulting fees and expenses would be substantially less than the consulting fees and expenses required in proceedings using the SSAC procedure now proposed by the Board, which would require substantially more time associated with research and analyses. In contrast to AAR's black box approach, STB's proposed SSAC approach could be characterized as a big, open ended and empty box which would be very expensive to fill.

Even though the currently proposed SSAC methodology will utilize the existing route and rely, in part, on STB-developed URCS data, there would remain a great deal of work to do. For example, a substantial amount of data would need to be furnished by the railroads and reviewed, analyzed and verified by the shipper, including all traffic data over the stand-alone railroad (SARR). Merely because the SARR is contemplated to be an existing route structure does not minimize the need to examine traffic data thoroughly, especially in light of the fact that the Board intends to allow a shipper to assert that parts of the putative SARR will not, in fact, be necessary to provide service. As such, the job of a cost consultant will be much more extensive under the STB's proposed SSAC procedure versus AAR's previously proposed and rejected SSAC approach.

Railroad Experts versus Shipper Experts

The STB's $200,000 estimate is also low because its is based on estimates from *railroad* experts, which would be different than the costs associated with *shipper* experts. The railroads maintain most of the necessary information and data required for the proposed SSAC procedure, which it can openly provide to its consultant and assist its consultants in the development and preparation of the required analyses. In other words, railroad experts face no internal railroad hurdles to jump over.

Shippers, however, must obtain the information and data in the railroads' computer systems and in their files, through time-consuming research, analyses and discovery and with no inside help, which increases consulting costs. In my Opening VS, I described some of the subjects that must be addressed to present a shipper's SSAC case. The list of issues that a shipper must research is long even without "efficiency" factors, unless the shipper is expected to simply accept the railroad's fact revelations without question.

The Railroads Present No Detailed
Cost Estimates of Their Own

The UP maintains that my estimated consulting fees are overstated. However, neither UP nor any of the other Railroad parties have presented similar detailed estimates of the required litigation costs. Instead, they rely on the STB's outdated and irrelevant estimate of $200,000. Again, Witness Klick has a substantial amount of experience in this area and could have presented similar detailed estimates of the consulting fees associated with the Board's proposed SSAC procedure which could be scrutinized and compared to the estimates that I developed. Witness Klick merely states that the $200,000 estimate is a "reasonable approximation." of the cost, but offers no such detailed estimates.[15]

Further, I should observe that Mr. Klick, or any of the railroads that have defended Full-SAC complaints (BNSF, CSX, NS, and UP), could have submitted evidence of their own consulting and legal expenses to do so. Their SAC litigation costs might have provided a benchmark against which to measure the presumably lower costs of an SSAC case. If, as I suspect, railroad legal and consulting costs in a Full-SAC case are much higher than those estimated by the Board as shipper costs, there would be good reason to accept the estimates of Mr. Crowley and myself.

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[15] Klick Reply, page 8. Witness Klick also states that "it may take two or three SSAC cases for the parties to reach equilibrium on these cases" and that shipper costs initially may be higher. I am not taking issue with Witness Crowley's estimates of $1.75 to $3.5 million, which includes legal fees. He has a substantial amount of experience in this area and his estimates could prove to be more accurate than mine. Moreover, like my estimates, Mr. Crowley's estimates are based on the Board's proposed SSAC procedure and not the decade-old and rejected AAR SSAC approach which is substantially different than the Board's proposed procedure. I merely point out that I am the only witness who has attempted to identify and describe in detail the individual work elements and time associated with the STB's proposed SSAC procedure.

Case by Case Differences

While I stand by my previous estimates, I agree with Witness Klick that it is difficult to predict these costs.[16] Each case would be different. For example, a case could involve a single origin and destination movement, a single railroad and a single commodity or a case could involve multiple movements of different commodities over several railroads. There are many other factors could influence the costs associated with presenting a SSAC case, such as the length of haul and the type of equipment (e.g., railroad or private). Therefore, the costs would vary significantly depending upon the specifics of the case. Consequently, I developed a range of values in an attempt to reflect these differences. In contrast, the STB's $200,000 estimate represents a "*on size fits all*" approach.

My Cost Estimates are Conservative

My estimates of consulting fees are conservative in many respects and serve to demonstrate that that Board's $200,000 estimate is far too low. As previously stated, my developed estimates of consulting fees do not include legal and other professional fees that would be required.

In addition, I have not included estimates of out-of-pocket expenses which could represent many thousands of dollars. For example, there could be substantial travel costs associated with the inspection of the issue route(s). STB filing and other fees (such as Waybill and URCS access fees) are also excluded.

Moreover, I have not applied a factor to account for contingencies, unforeseen events and other variables which can unexpectedly influence the cost of a

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16 Klick Reply VS, page 8.

case. These SSAC cases would involve much more than just straight number crunching. Legal and procedural issues, such as questions relating to contracts, market dominance and other issues can significantly influence the cost of a case. For example, my estimates effectively assume that all market dominance issues have been resolved when, in fact, market dominance often issues significantly increase the cost of a case.

<u>URCS Phase III Costing</u>

UP maintains that that my estimates include "duplicative" and "unnecessary" work.[17] It lists a selected series of line items in my Appendix GWF-2, submitted with my Opening VS that UP claims to represent an excessive estimate of consultants' time for an SSAC case. UP asserts that the "most obvious example of the inflated nature" of my estimates is the conclusion that "consultants would spend 324 to 744 hours – the equivalent of 50 to 93 eight-hour days – calculating variable costs using the Board's URCS Phase III methodology."[18] UP then lists eight line item entries from my Appendix GWF-2 to illustrate the alleged inflation of hours related to the Phase III URCS model.[19]

Union Pacific is either misreading or misstating my testimony. Appendix GWF-2 comes nowhere near allocating "324 to 744 hours" to URCS Phase III analysis. There are, in fact, only two specific line items that relate to URCS Phase III costing, and together they allocate 80 hours as a minimum and 200 hours as a maximum, which is substantially lower than hours represented by UP. Most of the eight specific items to

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17 UP Reply, page 33.

18 UP Reply at 32 and 33.

19 *Ibid.*

which UP points at page 33 of its Reply as allegedly representing an overstatement of URCS Phase III costing hours are in fact aimed at different issues.

Substantial Work Required Before
<u>Bringing a Formal Complaint to the Board</u>

UP references certain work elements that I identified as being required *before* a shipper decides to file a complaint. Filing a formal railroad rate reasonableness complaint with the STB is a major and very serious undertaking which cannot be taken lightly. It would be unwise for any shipper to file a complaint before as thorough as possible an evaluation has been performed.

Obviously, a shipper would want to know if the issue rate(s) generates revenue/cost ratios which exceed the Board's jurisdictional threshold of 180 percent *before* a compliant is filed. Not doing so could waste the Board's and everyone's time. A shipper would also want to know if it would be eligible for the SSAC procedure and obtain some idea of the potential outcome of the case, i.e., estimates the SSAC results, before a complaint is filed in order to evaluate the benefits and risks associated with filing such a case.

The work required before a complaint is filed can be difficult and time-consuming. STB railroad rate reasonableness complaints are rare events. Indeed, since the STB's creation in 1996, STB Annual Reports indicate that there were only 59 railroad rate reasonable cases received by the STB during the FY 1997 to 2004 period, the vast majority of which involved railroad coal movements and only one which would have employed the STB simplified rate guidelines.

Although some utilities may be familiar with the STB's complex rate complaint process, most non-coal shippers are unfamiliar with the STB process and would be likely to be uninitiated or lay shippers. Such lay shippers may not be knowledgeable of such things as URCS, STB exemptions, R/VC ratios, market dominance issues, bottleneck rules and other factors which are unique to the STB.

For example, a lay shipper may initially present an array of railroad movements for study. However, it could be subsequently determined that: a portion of the movements have rates which do not exceed the STB's jurisdictional threshold; a portion of the movements are exempt from STB regulation; a portion of the movements have competitive rail service or other market dominance issues; and/or a portion of the movements involved contracts. Therefore, the pre-complaint process could very well include some steps and analyses that are subsequently determined to be unnecessary and which are ultimately excluded from the complaint process.

During the pre-complaint process, it could also be determined that actual railroad movements are different from what was presented by the lay shipper. For example, a lay shipper may present a movement as moving from Origin A to Destination B, but shipping documents show that the movement actually moves from Origin A to Interchange Point B and then on to Destination C.[20]

<u>Initial Use of the Public Waybill Sample</u>

Before a complaint is filed a shipper is limited to the use of internal records and publicly available data, such as the Public Waybill Sample. The Public Waybill Sample usually contains the same number of records as included in the Confidential Waybill Sample (approximately 600,000 records), however, many of the fields are excluded or masked. For example, the railroad identification fields and specific

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20 For example, the Waybill Sample often lists Chicago as a destination for many records when, in fact, Chicago is the interchange point.

location code field are excluded from the Public Waybill Sample. Therefore, the identification of specific traffic is very difficult and time-consuming. The Public Waybill Sample includes the Origin and Termination Business Economic Area (BEA) for each record. BEA's may include hundreds, if not thousands, of individual locations and may be served by several individual railroads.

As a result, analyzing, identifying and segregating the individual records included in the Public Waybill Sample is complicated work. In this regard, the Board could reduce the amount of work required in the initial evaluation or pre-complaint stage by providing shippers access to the Confidential Waybill Sample before a complaint is filed.

Post-STB Complaint Revisions
Are Likely to Be Necessary

Unfortunately, after a compliant is filed and discovery has been obtained, much of the work performed in the initial evaluation of the rate(s), in all likelihood, would need to be substantially revised or even discarded in order to reflect the more accurate and detailed information obtained through discovery.

The Waybill Sample is, after all, a Sample. There can be substantial differences between the traffic captured by the Waybill Sample and the actual traffic. The actual traffic studied could be substantially higher or lower than the levels reflected in the Waybill Sample. I recently compared railroad movements of a specific commodity on a specific railroad included in the 2005 Waybill Sample with actual movement records for the same movements in 2005 that I obtained from clients in connection with another project. In this case, the Waybill Sample showed the movement of approximately

600,000 tons per year whereas the actual movement records reflected the movement of over 1.2 million tons per year.

It could also be the case that, due to the amount of time expired between the initial evaluation of the movements and the filing of a complaint, circumstances have significantly changed. For example, new movement data could be available when the complaint is filed, say 2006 rather than 2004 or 2005 data, which could significantly impact the results.

Any such required post-complaint revisions to the initial evaluations do not mean that the previously performed analyses were, as characterized by UP, "completely wasted"[21] In some cases, these initial evaluations may show that a complaint is not warranted or justified and thus could save the shipper a substantial amount of time and effort in the complaint process. In fact, it would not be a good business practice to file a complaint without performing such initial evaluations.

The Railroads' "Trust Us" Approach

The Railroads take a "*trust us*" approach by maintaining that the much of the work would be reduced or unnecessary because the defendant railroads would supply the data or perform the analyses. For example, UP maintains that verification of traffic data "should be unnecessary because defendants would be obligated to comply with the Board's rules."[22] The discovery disputes in previous SAC cases demonstrate that there are problems with this "trust us" approach and that a shipper in litigation would be foolish to be so trusting.

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21 UP Reply, page 34.

22 *Ibid.*, page 29

UP maintains that "a shipper could ask the Board to convene a technical conference to address any perceived disparities in the data."[23] However, such technical conferences would require a substantial amount of time in preparation and participation. A technical conference may shorten the case timetable, and dispense with the need for the Board to write a decision disposing of discovery issues, but will not avoid the preparatory work necessary for a shipper to make a presentation at the conferences.

Steady State Equilibrium

Witness Klick agrees that "it may take two or three SSAC cases for the parties to reach equilibrium on these costs."[24] His acceptance of the $200,000 figure represents the costs "once this "steady state" environment is achieved."[25] Since there are numerous uncertainties associated with the STB's proposed SSAC procedure and since neither the STB nor the Railroads have not provided SSAC testing, the first cases are likely to be very contentious and time-consuming. Thus, the consulting and legal costs associated with these first cases would be substantially higher than these so-called "steady state" cases. There has been 20 years of Full-SAC litigation and a "steady state" has yet to be reached in those cases. It is not realistic to expect or assume that such a "steady state" will be reached any time soon under the proposed new and untested rules and procedures.

Another problem here is that there will probably not be any, or a very limited few, "steady state" cases as a result of the STB's decisions in the first test cases

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23 *Ibid.*

24 Klick Reply, page 8

25 *Ibid.*

which will undoubtedly show that the approved SSAC procedure is extremely costly and generates extremely high revenue/cost ratios.

<u>SKMOL's $50,000 Estimate</u>

CSX and NS argue that a recent estimate made by Snavely, King, Majoros, O'Connor & Lee (SKMOL), an economic consulting firm, in a Three-Benchmark complaint proceeding that the litigation of the case will not exceed $50,000 demonstrates that the Board $200,000 level is reasonable.[26]

First, this is an apples to oranges comparison. SKMOL's $50,000 estimate is based on its experience in one case that arose under the STB's existing Three-Benchmark approach and not the STB's proposed SSAC approach. As I demonstrated in my Opening VS, the costs associated with presenting a Three-Benchmark case would be substantially lower than the cost to present a SSAC case. Therefore, the $50,000 estimate cannot be compared to the Board's $200,000 estimate.

In any event, I believe that the SKMOL estimate for a Three-Benchmark case is too low even for that type of case under the proposed rules. In my Opening VS, I estimated that the consulting fees in a Three-Benchmark case would range from $115,325 to $225,750 exclusive of legal fees and expense outlays, and I stand by those estimates.

It should be noted that SKMOL is not a law firm and apparently filed the case without the assistance of a law firm. The cited case is currently in mediation. If this case moves forward at the STB, it is likely that additional legal and consulting fees would be required.

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[26] CSX/NS Joint Reply, pages 14 and 15 citing the complaint filed in STB Docket No. 42098, <u>Williams Olefins v. Grand Trunk Corp</u>, dated November 22, 2006.

CSX and NS also state that SKMOL "were consultants to the complainant in the only case brought under *Simplified Guidelines* (i.e. BP Amoco Chem. Co. v. Norfolk S. Ry, STB Docket No, 42093 (served June 28, 2005)) they presumably have first hand knowledge of the likely cost of litigating a small case."[27] The BP Amoco case was settled by the parties before the Three-Benchmark evidence was presented to the STB. Therefore, SKMOL does *not* have experience in presenting such evidence to the Board.

Among the differences between a Three-Benchmark case under the existing rules that BP-Amoco used and the proposed rules is the absence in the former of any need to do a "confidence factor" analysis. Further, BP-Amoco was a narrowly defined case, probably not emblematic of most small cases, in that it involved short movements of a highly specialized hazmat commodity and, most significantly, very low traffic volumes over the subject routes without any of the "aggregation" issues that would be present under the proposed rules.

For instance, under the proposed aggregation rules, a shipper would have to thoroughly analyze *all* of its traffic from the complaint origin to see how much might be a candidate for a complaint and could not necessarily be as selective as was BP-Amoco. This would add a significant amount of time and costs.

27 *Ibid.*, page 15

South-West Car Parts Case

In the STB's first Annual Report submitted to Congress by then Chairman Linda Morgan, the Board cited a decision in STB Docket No. 40073, South-West Railroad Car Parts v. Missouri Pacific Railroad (Car Parts) as one its most significant and important decisions during its first months of operation:

> Also in December 1996, in the South-West Car Parts case, the Board used these simplified guidelines to tentatively resolve a rate complaint that had been held in abeyance pending the adoption of the new procedures. The available revenue-to-variable cost benchmarks indicated that the rates charges were consistent with the carrier's revenue requirements and were not disproportionately high compared to other traffic of its type. Thus, the Board preliminarily concluded that the rates were not unreasonably high, although it gave the shipper the opportunity to present further evidence and argument.[28]

Concerning the Car Parts decision, the STB also told Congress that it had "Applied the newly-adopted simplified rate guidelines to a long-pending rate complaint, find the rate not unreasonable."[29] Although Car Parts was viewed as a significant and important case by the STB a decade ago, it was completely ignored by the Board in its NPRM in the instant proceeding served July 28, 2006.

As noted in my Opening VS, I was the primary expert witness in the Car Parts case. In that case, I prepared and presented expert economic testimony employing what was then the R/VC_{COMP} test and other aspects of the then-proposed Three-Benchmark test. Therefore, I do have "first hand knowledge of the likely cost of litigating a small case." In that proceeding, our consulting fees alone exceeded $50,000 - and that case was initiated over a decade ago and our fees excluded the legal costs.

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28 STB 1997/1997 Annual Report, dated March 16, 1998, page 19.

29 *Ibid.* page 65.

Assuming the Best Case Scenario

I suppose that there could be the very rare occasion in which the initial rate evaluations prepared before the complaint is filed are up-to-date and accurate and thus only minimum changes are required during the complaint phase. However, it has been my experience that STB rate reasonableness cases most often involve a continuing and evolving process in which the required analyses are constantly being refined and revised to respond to evidence submitted by the railroads and the use of more accurate information.

Assuming the best case scenario, however, the litigation cost in an SSAC case would still greatly exceed $200,000. For example, UP is critical of what it terms as "duplicative" work."[30] However, even if the hours in my chart that are allocated to URCS Phase III costing are cut in half to satisfy UP's unmeritorious complaints about "duplicative" work, my estimated consulting fee would still range from $526,750 to $1,226,600, which again excludes legal fees.

Under the best case scenario, I assume that it could be possible that the actual consulting fees associated with the STB's proposed SSAC procedure could be slightly lower than my estimates. However, I cannot foresee any case employing the STB's SSAC approach is which the consulting and legal fees would be less than $500,000. I believe it is clear that the total litigation costs would likely be substantially higher than the STB's $200,000 figure.

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[30] UP Reply, page 33

Commonwealth of Virginia)
) : **ss**
City of Alexandria)

Gerald W. Fauth III, being duly sworn, deposes and says that he has read the foregoing document and attachments thereto and knows the contents thereof, and that all matters and things set forth therein are true.

Gerald W. Fauth III

Subscribed and sworn to before me this tenth (10) day of January, 2007

Notary Public

My Commission expires May 31, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have on this 11th day of January, 2007, served a copy of the foregoing Rebuttal Comments on all parties of record, by first class mail, postage prepaid.

Aimee DePew